In the Matter

of

Reality Associates Securities Corporation,

Petitioner,

Manufacturers Trust Company, Intervening Petitioner,

Appellant,

vs.

Reality Associates Securities Corporation and Consolidated Reality Corporation,

Respondents.

REPLY BRIEF.

Percy A. Hull,
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The Court Press, N. Y. C.

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Supreme Court of the United States

OCTOBER TERM, 1947.

No. 405

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,

Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

REPLY BRIEF.*

Respondents have signally failed to negate the conflicts inherent in the decision below or the confusion bound to occur in its wake. It is significant that respondents have not cited in opposition a single authority apposite in this premise. Their argument shows up, in bold relief, the importance and anomalous character of the precedent below, and emphasizes the radical departure from established practice. We touch only the basic points, generally in the order and under designations given in their brief.

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* Manufacturers Trust Company is herein referred to as "petitioner"; its Petition and Brief as the "Petition" and the Brief of the Securities and Exchange Commission as the "S. E. C. Brief".

1.

A. The *Vanston* Case Does Not Oppose the Allowance of Interest on Claims Against a Solvent Estate or the Judgment Theory.

The judgment theory[1] and other equitable principles for allowance of interest on claims[2] apply *only* in event of solvency or a sufficiency of assets to pay all claims in full as well as interest thereon—where the equities must be balanced between a debtor and its creditors.

The *Vanston* case involved continued insolvency where an allowance of interest upon first mortgage coupons would have resulted in a corresponding loss to subordinate creditors.* Absent solvency, there was no point at which there could have been applied the judgment theory or any other theory as to allowance of interest on creditors' claims. Hence, Inland bondholders could not be accorded judgment rights against a debtor which had no equity in the assets (see Respondents' Brief, pp. 7-9) and the equities were weighed solely between classes of creditors.**

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* A fact not altered by assertions on rehearing that, by reason of the disallowance of such interest, assets were sufficient to permit some payment on debtor's stock.

** Respondents claim (p. 10) that insolvency was "immaterial" in the *Vanston* case because a sufficiency of mortgage collateral existed. But had assets been sufficient, all valid interest engagements would have been allowed. Hence respondents' argument only brings more clearly into focus (a) the extent to which this Court went in cutting across contract rights and even across the strict priority rule in order to assure equity and fairness in that case and (b) the fact that *only* insolvency made it necessary so to do.

1 *National Bank of the Commonwealth of the City of New York* v. *Mechanical National Bank*, 94 U. S. 437; *Re*: *John Osborn's Sons*, 177 Fed. 184 C. C. A. 2nd.

2 *Johnson* v. *Norris*, 190 Fed. 459, C. C. A. 5th; *Sexton* v. *Dreyfus*, 219 U. S. 339.

Certain equitable principles may apply in both solvency and insolvency, but the judgment theory and the principle finally applied in the *Vanston* case and the *Traphagen* case are applicable only in converse or opposite circumstances. They do not oppose each other, but are consistent and concordant.

The *Vanston* Case Differs in All Material Respects from the Case at Bar and Does Not Determine the Questions Here Raised.

Patently untrue is resonpdents' statement that the facts of this matter "are in every material respect identical with the facts" in the *Vanston* case (p. 8), for that case involved the "allowance of a claim" *ex contractu* for interest on coupons [not the allowance of simple interest upon a liquidated "claim"], several classes of creditors, an insolvent debtor, and post-petition interest unpaid for 16 years by Court order.*

In contrast, the principal question raised by the Petition concerns allowance of interest upon a matured claim of a single class of creditors for a liquidated sum consisting of principal and interest, all due at the time of the petition—and particularly the base for computation of such interest, viz whether interest due

* Respondents' assertions (p. 10) only point up the error of the Circuit Court in denying in reorganization proceedings anything but interest "contracted for" or made the subject of pre-petition "bargain".

They state that the *Vanston* case refused to enforce a contract right to interest on interest because "the delay in payment was . . . for the benefit of all parties". But this Court there pointed out that interest would be allowed when compatible with equitable principles invoked in cases of solvency or "where an estate is ample", and contract interest on coupons was then denied as not in accord with equitable principles because "enriching" one class of creditors with "corresponding loss" to another.

at maturity can constitute a "claim" or part of a "claim" under Section 63 (a) 1 of the Bankruptcy Act for the purpose of allowing interest (SEC Brief, pp. 3, 8, 16). Such an allowance of interest depends solely upon equitable principles, independent of contract and the strict propriety rule.

The *Vanston* and *Traphagen* Cases Afford Precedent for Equitable Action in This Case, Even If It Be Assumed *Arguendo* That Bondholders Are Bound by the Indenture as to Post-Maturity Interest.

The *Vanston* case, "cut across the face"* of a presumably valid contract to obviate a situation deemed incompatible with the equitable principles governing bankruptcy distributions. *Fleming* v. *Traphagen* (329 U. S. 686) cut across the face of an admittedly valid contract even though the mortgage security was adequate to pay same.

If, on such authority, a reorganization court in balancing equities between creditors must cut across the face of a valid contract to assure fairness and equity—it should do likewise in balancing equities between creditors and debtors.

To the extent that debtors, possessed of means with which to pay such interest, avoid payment of interest on money profitably used during reorganization, they are certainly "enriched"**—and creditors obviously

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* Phrase quoted as coined by respondents. The better choice of language would indicate that a reorganization court, as a court of equity, simply subordinates the troublous terms of the contract to the paramount demands of fairness and practical justice. (See Petition, pp. 28-29, 34-35 and Point IV.)

** Debtor's actual net income during the Chapter X Proceedings was $494,821.44 before Trustees' fees and reorganization expenses and without computing capital losses upon the sale of real estate which did not affect debtor's income. This is more than 7% on bondholders claim of $6,977,046.43.

"suffer a corresponding loss" of use of the moneys due them at the time of the petition.*

Such situation is no more compatible with any known principle of equity than was that in the *Vanston* and *Traphagen* cases. The inequity can only be eliminated, and the equities fairly balanced, by cutting across the face of any contract (or pre-petitioned "bargain") which gives rise thereto and by requiring payment of interest on the whole amount withheld from creditors.

In paying interest on moneys profitably used in its business a debtor is not deprived of anything—as one seeking equity, it does equity. By the same token creditors are recompensed for the loss of income on moneys used by the debtor and which, but for the stay, would have been the subject of summary judgment bearing 6% interest in New York as of a date approximating the filing of the petition.

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* Respondents assert (pp. 23-27) that in a reorganization proceeding creditors do not actually "sustain a loss" and are "not damaged" because such proceedings are for their benefit as well as that of a debtor and its stockholders. That argument is unrealistic as well as contrary to the rule that, where assets permit, interest is always allowed on "claims" against a bankrupt—a rule which to date has no exception.

Actually, more occasion exists for invoking the judgment theory in Chapter X where the going business as an entirety is returned to debtor and stockholders, than in bankruptcy or equity where the business is lost in liquidation.

B. The Uniform Practice in Computing the Amount of a "Claim" in Bankruptcy or Reorganization Proceedings Differs From, But Does Not Oppose, the Allowance of Interest Upon the Full Amount of a "Claim" Matured and Liquidated at the Time of the Petition.

(i) All Cases Cited by Respondents as to the Rate of Interest Are Foreign and Inapplicable to the Present Problem.

Respondents cite *Coder* v. *Arts* (213 U. S. 510), for the proposition that contract terms prevailed after the filing of the petition irrespective of equities given recognition in Bankruptcy. But the "cut-across" principle of the *Vanston* case is a perfect example to the contrary. Furthermore, in *Coder* v. *Arts* no question was raised as to either (a) interest upon a "claim" matured at the time of the petition or (b) any difference between the contract and legal rates of interest.*

Obvious distinction exists between (a) computing the amount of a "claim" to a fixed date pursuant to a Plan of Reorganization for an insolvent debtor, and (b) the equitable allowance of interest, where assets are sufficient, upon an allowed "claim" which matured at the time of the petition. In the former, no occasion whatever exists to consider the allowance of interest upon "claims" as already allowed under Section 63 (a) 1.

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* There a Trustee, challenging the legality of a mortgage, sold the mortgaged property which brought more than the mortgage debt and was, therefore, directed to pay the mortgage debt from those proceeds. (15 L. R. A. [N. S.] 372, 379). That principal does not conflict with the *Vanston* case or the principles here advanced on behalf of creditors.

In the railroad cases cited by respondents,[3] interest *ex contractu* was computed to a given date solely for the purpose of issuing, pursuant to plan, new securities of lessor rank or amount than the original securities. Each of these railroad cases, without exception, is, therefore, in all respects inapposite to the problems raised by the Petition.

(ii) The Interest on Interest Cases Cited by Respondents Are Clearly Inapposite.

We have just shown that the *Ecker* case and the *Rock Island* case are inapplicable herein.

In citing *In re Norcor Mfg. Co.* (36 F. Supp. 978 E. D. Wis. 1941), respondents omitted to explain that same involved a claim for royalties which was not predicated upon a contract calling for interest as part of the obligation. Clearly, therefore, that case is inapposite and the District Court below has pointed out at length just why that case is not at variance with creditors' position in the case at bar (R. 180, fol. 540).

C. Respondents' Treatment of Cases Cited in Support of the Petition Only Confirms That the Conflict Inherent in the Prevailing Opinion Below is Self-Evident.

In stating (p. 20) that the *Osborn* case "did not involve any question of interest upon interest" re-

[3] *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448; *Brooks* v. *St. Louis & San Francisco Railway Company*, 153 Fed. (2) 312; *Chicago Rock Island & Pacific Railway Reorganization*, 157 Fed. (2) 241; *Missouri Pacific Railroad Reorganization*, 64 Fed. Supp. 64; *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization*, 48 Fed. Supp. 330; *Chicago, Milwaukee, St. Paul & Pacific Railway Reorganization*, 145 Fed. (2) 299; *In re Wisconsin Central Railway Co.*, 63 Fed. Supp. 151.

spondents avoid the **obvious and very important facts** viz: (1) the Circuit Court below distinguished its ruling herein from its ruling in the *Osborn* case by stating that in said case "the bankrupt had made no contract providing for the payment of interest", (2) thus indicated that in Chapter X it would only allow interest *ex contractu* and (3) in addition established a precedent which splits all claims into two categories—viz. claims for interest which would not be entitled to interest, in event assets were sufficient, and claims for principal which would.

Error Is Evident in Respondents' Treatment of the *Osborn* case and *Johnson* v. *Norris* and as to the Effect of the Ruling Below in Respect to Interest Upon Claims Consisting Wholly or Partially of Interest.

The *Osborn* case, necessarily involved only claims allowed under Section 63 (a) 1 of the Bankruptcy Act but made no distinction between claims representing interest or claims representing principal. It shows no exception to the rule that all claims allowed under said Section have the same status.

Section 63 (a) 1 specifically provides that provable debts include "interest recoverable" on the date of the petition. When so proven such a debt becomes a "claim". Undeniably a "claim" for interest due at the time of the petition may be voted and is otherwise accorded the same status, rights and "dignity" as any other claim (see authorities at p. 20 Petition).

A claim consisting in part of interest never has

been denied the right to interest, *Johnson* v. *Norris* (190 Fed. 459).*

Respondents' arguments simply make more apparent the urgency for review and revision herein by *first* denying the same rights and incidents to a claim for interest as to a claim for principal and *second* denying any rule in Chapter X for payment of interest on claims matured at the time of the petition, where assets permit, unless arising *ex contractu*.**

D. *Contra* Assertions of Respondents, Important Constructions of the Bankruptcy Act Are Involved.

It is a matter of utmost importance that it be determined whether Sections 102, 106, 114, 115 and 200 take effect in a Chapter X reorganization, where the

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* Respondents assert (p. 21) that *Johnson* v. *Norris* "does not present a conflict with the decision below". In view of the cogent and directly analogous facts of that case (quoted Petition, pp. 30-31), the application herein of entirely different principles makes the conflict self-evident.

** If this view be sustained, then [A] post-petition interest on Chapter X claims will be allowed only on the base and at the rate provided by contract, affording inequitable advantages to such contracts, [B] creditors in Chapter X will be deprived of rights long recognized in straight bankruptcy, [C] notwithstanding the rule in the *Vanston* case (see footnote 8 thereof), the provisions of §§ 102, 106, 114, 115, 200 and 63A(1) of the Bankruptcy Act would not be applicable in Chapter X if the debtor be solvent and [D] **an entirely new and novel relationship will exist between creditors and solvent debtors in Chapter X and even in straight bankruptcy**—one heretofore unknown in equity or bankruptcy and in direct conflict with the practice long established in such matters—**for a claim for interest due at the time of the petition would not carry the same rights as other claims.**

It must be clear that every time any one of those subjects is raised the decision of the Circuit Court of Appeals herein will be cited in opposition to the rights of creditors. The consequent conflict and confusion is not to be underestimated.

debtor is solvent, inasmuch as the *Vanston* case clearly indicates that same are applicable where there is insolvency (footnote 8 thereof).

Of like significance is the question whether under Chapter X a claim representing interest due at the time of the petition should have a different and lesser status and different and lesser incidents than a claim for principal due on the same date.

Is the decision of the Circuit Court below to stand as precedent and authority that the Congress did intend to deprive creditors in Chapter X of rights against a solvent debtor which creditors of a bankrupt would have under Section 63 (a) 1?

It should be for this Court to weigh and determine whether, as claimed by respondents (p. 25), Chapter X contemplates "the continuance of the business of the debtor, a continuation of the contractual relationship between the debtor and its creditors", and whether, then, Chapter X contemplates the equitable continuation of a solvent debtor's obligation to pay for the use of moneys withholden from creditors during a reorganization proceeding.

Practically all bankrupts are insolvent, yet are obliged to pay interest on claims, where the estate is sufficient, as a reciprocal equitable duty resulting from the bankrupt's right to obtain the statutory stay *ex parte* (*Johnson* v. *Norris, supra*). This Court alone should determine whether a solvent debtor is to be exempt from the corresponding equitable obligation to pay, for every equitable consideration and authority supports the theory that the Congress intended the same equitable rule to hold true in reorganizations as in bankruptcy where equitable principles prevail (*Vanston Bondholders Protective Com.* v. *Green, et al., supra*).

Not one of the many decisions cited by respondents hold that in a Chapter X proceeding interest is not allowable as in bankruptcy.

Even the prevailing opinion below (R. 214-215) admits

> "the point does not appear to have been discussed"

and, as we have shown ("B" above), could only cite cases which were in all respects inapposite.

There is, however, adequate authority to the contrary, set forth in both the Petition and the SEC Brief.* The cases which allow interest where assets are sufficient [including the judgment theory] show no exceptions to such authority.

2.

The Construction Given the Contract Below Violates Contract Rights of Creditors Under the Local Law and Denies to Them a Just Balance of Equities in This Case, as Shown in Points IV and V of the Petition.

3.

It Is Respectfully Submitted That the Writ Be Granted.

Respectfully submitted,

PERRY A. HULL,
Counsel for Petitioner.

NEWMAN & BISCO,
Attorneys for Petitioner.

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* Debtor's statement (p. 23) that certain decisions were made prior to the *Vanston* case does not answer *fact* #1 that such cases represent the practice as now established or *fact* #2 that the interpretation of the *Vanston* case given below and by debtor is radical departure from such practice—indisputable evidence of conflict.

IN THE

Supreme Court of the United States

October Term, 1947

In the Matter of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

No. 405

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 406

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,
Petitioners,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 407

VANNECK REALTY CORPORATION,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

Legal Intelligencer, 1216 Chestnut St., Phila. 7, Pa.

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ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by the Reconstruction Finance Corporation. Consolidated Realty Corporation, in turn, owns all of the stock of the debtor, Realty Associates Securities Corporation. The Securities and Exchange Commission is a statutory party herein pursuant to Section 208 of the Bankruptcy Act, 11 U.S.C. § 608, and its position in the instant matter in support of the petitions for certiorari is contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of these two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U.S. 758 (1944).

PHILIP B. PERLMAN,
Solicitor General.

OPINIONS BELOW

The opinion of the District Court (R. 171) is reported at 66 F. Supp. 416. The opinion of the Circuit Court of Appeals (R. 209), modifying the order of the District Court, is reported at 163 F. 2d 387.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 23, 1947 (R. 222). The petitions for writs of certiorari were filed on October 20, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U.S.C. §347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U.S.C. §47(c).

QUESTIONS PRESENTED

(1) Whether the substantive rights of creditors to accrue interest on their claims are less in a Chapter X reorganization than in straight bankruptcy?

(2) Whether creditors holding matured and undisputed claims against the debtor on the date of a voluntary Chapter X petition, which claims consist of unpaid principal and interest, and which were prevented from being reduced to judgment by the debtor's resort to Chapter X, are entitled as against a sole stockholder upon dismissal of the proceedings and the return of the properties to the solvent debtor (a) to interest on the entire amount of their claims, including that portion representing interest accrued prior to the filing of the petition, and (b) to accrue such interest as may be allowed at the rate applicable to judgments rather than the contract rate.

STATEMENT OF FACTS

The debtor, Realty Associates Securities Corporation, deals in mortgages and other real estate interests (R. 4-5) and the respondent, Consolidated Realty Corporation, is its sole stockholder (R. 7). The Chapter X petition was filed by the debtor on September 28, 1943 in contemplation of the imminent maturity of a large publicly held bond issue due three days later, October 1, 1943 (R. 6). This was the principal (and practically the sole) indebtedness of the debtor, and its petition alleged that while the value of its assets exceeded "total liabilities inclusive of its capital stock," a forced sale might bring in less than the true value of the assets to the detriment of the stockholder interests (R. 6).

The bonds were originally issued in three series of $5,000,000 each in 1925, 1927, and 1928, due 1937, 1939, and 1943, respectively (R. 5; 8), and bore unconditional rights to 6% interest semi-annually (R. 42; 52; 62). On July 10, 1933, when some $12,450,000 principal amount was still outstanding, the debtor filed a voluntary petition in bankruptcy (R. 5; 8). The bankruptcy proceeding was terminated the following year as the result of a composition effected by the debtor. The composition involved a 15% payment on account of the outstanding indebtedness, an

extension of the remaining debt (including all three bond issues) to October 1, 1943, and a reduction in the interest rate thereon from 6% unconditionally to 5% "if earned." (R. 78). An amended indenture, dated as of July 10, 1933, defined "earnings" for interest purposes to permit deductions of capital losses provided that such losses could not be used to reduce interest below 3% per annum (R. 78; 92). Unpaid portions of the 5% annual interest were made cumulative and payable out of future earnings, or unconditionally at maturity (R. 10; 92). As a result, instead of being wiped out by bankruptcy, the debtor obtained a ten year moratorium which included substantial alleviation of its interest obligation.

During the moratorium years which followed, the debtor paid approximately 3% per annum, and took advantage of the unique definition of earnings to defer the remainder, thus retaining for its own use money which otherwise would have been payable to the bondholders.[1] As the extended maturity date approached, the debtor found itself still owing $5,710,400 in unpaid principal (R. 6; 191) and $1,286,646.43 in unpaid interest (R. 5; 10; 191). According to the Chapter X petition, it then had assets with a book value of nearly $13,500,000 (App.[2] b4), including approximately $1,261,000 in cash. (App. b7) and $1,760,069 in readily marketable securities (App. b3). Despite the availability of liquid assets more than sufficient to satisfy all interest claims, no payment of these claims was proffered. Instead, the debtor first attempted, in July of 1943, to obtain another voluntary extension and composition of the indebtedness and, failing in this, resorted to Chapter X to stave off the enforcement remedies normally available to the bondholders.

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[1] See Statement of Earnings for the Six Months Ending April 30, 1943 (R. 138), for an illustration of the deduction of capital losses.

[2] "App." refers to the Appendices to Petitioners' Brief in No. 405, Filed Pursuant to Stipulation Dated September 26, 1947.

The Chapter X proceeding lasted nearly 18 months and was dismissed on April 2, 1945 on the petition of the debtor and its sole stockholder, Consolidated Realty Corporation (R. 7, 25). By that time the debtor's business situation and the value of its assets had improved sufficiently to persuade the stockholder respondent to advance it the funds necessary to discharge the indebtedness. The petition for dismissal, however, denied any liability for interest beyond 5% on the unpaid principal to April 15, 1945, the date fixed for payment and settlement (R. 26; 172). The court's dismissal order, provided for payment of the undisputed claims for principal and interest, and for a reserve to be retained by the Chapter X trustees sufficient to pay any additional amounts which might be allowed (R. 26 *et seq.*). Jurisdiction was reserved to adjudicate, *inter alia*, the dispute as to the proper interest rate and base, the specific issues with respect thereto being:

(1) Whether interest is payable after the institution of the Chapter X proceedings on that portion of the bondholders' claims which represented unpaid interest accrued prior to that date; and

(2) Whether interest on the bonds, matured as of October 1, 1943, accrued during the Chapter X proceedings at the rate of 5%, as the debtor and its sole stockholder contend is provided by the indenture, or at 6%, the judgment rate which the bondholders contend should equitably be applied since they were prevented from obtaining judgment by the debtor's petition for reorganization.

The District Court held that the bondholders were entitled to 6% judgment interest on their entire claim including unpaid principal and interest accrued to the date of maturity and the filing of the Chapter X petition [3] (R.

[3] Throughout these proceedings the date of the Chapter X petition and the maturity date of the bonds have been treated essentially as one; for, as previously noted, the petition was

171-181; 191). On appeal by the debtor and its sole stockholder, a majority of the Circuit Court of Appeals (Judges Swan and Learned Hand), construed the indenture as providing for a 5% rate of interest on the unpaid principal of the bonds after maturity,[4] and held that interest was payable at that rate and only upon the portion of the bondholders' claim which represented unpaid principal (R. 217). The judgment of the District Court was modified accordingly (R. 218). Judge Clark, dissenting, expressed the view that equitable considerations required the allowance of the 6% judgment rate of interest on the bondholders' entire claim, including interest accrued prior to the abortive Chapter X proceeding (R. 218).[5] The instant petitions for certiorari followed.

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filed only three days earlier and admittedly in contemplation of the imminent maturity of the bonds.

[4] While we believe that the indenture, properly construed, does not contain any applicable post-maturity rate of interest on the bonds and that, therefore, they bear the legal rate of interest after maturity, we do not press at this time our disagreement with the decision of the court below on this point. This interpretative issue is of no significance if petitioners are correct in contending that interest should be allowed on their claims as if they had been reduced to judgment.

[5] The Indenture Trustee had also appealed from another portion of the District Court's order which applied an interim payment first towards reduction of the bondholders' original claim, rather than upon the interest which had accrued during the course of the Chapter X proceedings (R. 191; 197). The Circuit Court found that such application produced a difference in the amount to which the bondholders were entitled only if more than 5% interest were payable, and in view of its holding as to the proper interest rate and base, regarded this aspect of the appeal as academic. Accordingly, this portion of the District Court's order was affirmed (R. 218).

ARGUMENT

The petitions present questions of importance in the administration of Chapter X of the Bankruptcy Act which we believe should be decided by this Court. The rights of creditors holding matured and undisputed claims against a debtor to accrue interest on those claims from the date of the petition at the rate applicable to judgments where, but for the petition, they would be entitled to reduce those claims to judgment and receive interest thereon at the judgment rate, is a federal question which, in the context of a reorganization proceeding, has not been, but should in our opinion be, considered by this Court. Improved business conditions and appreciations in asset realization values during the past few years have provided surpluses after payment of the principal of creditors' claims in many estates being administered under Chapter X, with resultant conflict between creditors and stockholders as to the validity and extent of the interest claims payable out of such surpluses. Thus, the question here presented is of recurrent importance under present business conditions.[6] We believe it was erroneously decided by the majority of the court below. In our opinion, the decision below introduces novel distinctions between allowable claims in straight bankruptcy and in Chapter X reorganizations which are unwarranted by the provisions and underlying purposes of the Bankruptcy Act. The determination below also runs counter to well established equitable doctrines applicable in federal liquidation and reorganization proceedings.

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[6] For example, aspects of this problem have recently been presented in the following reorganizations in which the Commission is a party: *In re Childs Company*, 69 F. Supp. 856 (S.D.N.Y. 1946), and S.E.C. Corp. Reorg. Release No. 67, C.C.H. Bankruptcy Law Service, par. 55,734; *In re United States Realty & Improvement Co.*, S.D.N.Y., Bkcy. No. 83280, order approving plan dated May 14, 1946, par. 18; *In re Equitable Office Bldg. Corp.*, S.D.N.Y. Bkcy. No. 78476, order approving plan dated October 24, 1947, appeals pending in the court below.

1. As previously noted, the decision below introduces a distinction between the allowable claims of creditors in straight bankruptcy and in Chapter X reorganization which is wholly unwarranted by the statute. The court below expressly recognizes that "allowed claims in bankruptcy are of the same efficacy as judgments with respect to bearing interest, where the assets of the bankrupt are sufficient" (R. 214). It had expressly so held in *In re John Osborn's Sons & Co.*, 177 Fed. 184 (1910),[7] a straight bankruptcy case, relying upon the ruling of this Court in *National Bank of the Commonwealth of New York* v. *Mechanics National Bank*, 94 U.S. 437 (1876). The latter case involved the liquidation of a New York bank under the National Banking Act [8] and the depositors were held to be entitled to interest on demand deposits from the date of demand at the rate applicable to judgments in the State of New York. This Court then stated (94 U.S., at 439):

> "If these claims had been put in judgment * * * the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment, because they were proved to the satisfaction of the comptroller. After they were so proved, they were of the same efficacy as judgments, and occupied the same legal ground."

Insofar as the decision below treats the principal amount of the bonds as differing from the accrued interest as respects its status as an interest bearing claim, the decision is contrary to Section 63(a)(1) of the Act, 11 U.S.C.

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[7] Appellants in the court below attempted to distinguish the *Osborn* case because of the failure of the bankrupt in that case to make any contract for the payment of interest. The court below stated, however (R. 214): "Assuming without decision that the attempted distinction would be invalid in an ordinary bankruptcy, we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization. . . ."

[8] Recently, in *Vanston Bondholders' Protective Committee* v. *Green et al.*, 329 U.S. 156 at 165 (1946), in dealing with a specialized interest problem in a Chapter X proceeding, this Court referred to bank liquidation cases as involving analogous principles.

§ 103(a)(1), which is applicable to a Chapter X proceeding as well as an ordinary bankruptcy, and which provides that an allowable claim shall include a fixed liability of the debtor, together with any interest thereon which would have been recoverable at the date of the petition. Under this provision principal and interest accrued to the date of the petition are treated as part of the creditor's single claim against the estate, just as they would be treated as a single claim if reduced to judgment. Thus, in *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt.[9] In the present case, at the date of the Chapter X petition the bondholders' claim against the debtor amounted to $6,997,046.43, of which $1,286,646.43 represented interest accrued and accumulated prior to the Chapter X proceedings. Contrary to the statute, the holding below denies the creditor the full right to treat the accrued interest as part of his claim for the purpose of an allowance of interest.

The majority of the Circuit Court of Appeals differentiated straight bankruptcy from reorganization, and decided that, in the latter proceeding, creditors possessing matured and undisputed claims which would have been reduced to judgment but for the Chapter X petition, were not entitled to have their claims for principal and accrued interest treated as if reduced to judgment because, in the majority's view, Chapter X contemplates a "moratorium" for the debtor precluding the recognition of those claims as "peremptory demands, like judgments, upon which dam-

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[9] In *Ohio Savings Bank & Trust Co.* v. *Willys Corp.*, 8 F. 2d 463 (1925), the court below, in an equity receivership proceeding, applied the same theory in allowing interest on creditors' claims, part of which had represented interest accrued prior to the institution of the proceedings.

ages in the form of interest for delay in payment" is payable (R. 214).[10]

The attempted differentiation is apparently predicated upon the assumption, a fallacious one as we show below, that the greater remedial restrictions imposed by Chapter X in the interest of facilitating reorganization, require a holding that the claims of creditors in Chapter X are less than in straight bankruptcy. On the contrary, Section 200 (11 U.S.C. §600) provides that the rights of creditors with respect to the property of the debtor shall be the same in Chapter X as in straight bankruptcy unless "inconsistent with the provisions of this chapter"; and there are no provisions which would indicate that the substantive claims of creditors are less in Chapter X than in straight bankruptcy. If anything, they may be greater: See *e.g.*, the broad definition of "claims" in Chapter X which is set forth in Section 106(1), 11 U.S.C. §506(1).[11] So far as we know, this purported distinction, which conflicts with basic provisions of the Bankruptcy Act and runs counter to its underlying policy, is made for the first time by the court below.

2. Apart from the express statutory mandate that the substantive rights of creditors in Chapter X shall conform

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[10] The decision below does not push the concept of moratorium to the point of disallowing as between creditors and the debtor any "damages in the form of interest," a result recognized to be contrary to settled authority. Instead, that portion of the claim which represents accrued interest, assumed to be a non-interest bearing claim under local law unless reduced to judgment, was continued as a non-interest bearing claim and the bondholders were allowed 5% interest on the unpaid principal, which the court below held to be the post-maturity interest rate provided by the indenture. See pages 12-17, *infra*, where we discuss the inequity of the concept of moratorium so applied.

[11] Section 106(1) provides that claims recognizable in Chapter X include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of the Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent."

to those in ordinary bankruptcy, there are other important reasons why the substantive scope of a creditor's claim should not depend on whether Chapter X or straight bankruptcy is invoked. Thus, we believe that the choice of proceedings should depend upon the prospects of realizing or preserving through reorganization, values for the totality of interests affected which might be lost in a straight bankruptcy proceeding. However, if the amount of the creditor's claim which will be recognized is less in a Chapter X proceeding than in ordinary bankruptcy, basically irrelevant considerations will be introduced which will tend to intensify conflicts of interest between different classes of security holders as respects the appropriate choice of proceeding. In a case, such as the instant one, involving a controversy between a single class of creditors and the stockholder interests, the decision below can only have the effect of stimulating creditor opposition to the reorganization process.

The decision below also creates certain other difficulties in the administration of the Bankruptcy Act. For example, Section 238(1), 11 U.S.C. § 638(1), provides that where a Chapter X proceeding is ultimately converted into a straight bankruptcy liquidation, the proceeding shall be conducted so far as possible in the same manner and with like effect as if an involuntary petition in bankruptcy had been filed at the date of the Chapter X petition and a decree of adjudication entered when the Chapter X petition was approved. It would seem to follow from the doctrine enunciated by the majority of the court below that although judgment interest would be denied during the Chapter X "moratorium", it would be required to be allowed retroactively to the date of the original reorganization petition in the event that the proceedings were transferred to straight bankruptcy. It hardly needs to be emphasized that a creditor's substantive rights should not be based upon such a contingency.

Again, the determination below would afford an inequitable advantage to certain creditors in a case where,

because of special circumstances unrelated to the propriety of preferential treatment of their claims, these creditors were permitted by the Chapter X court to pursue their claims to judgments after the filing of the petition.[12] In the event that there are assets available for the payment of interest on allowed claims, the ruling below would require that interest be payable on the newly acquired judgments at the judgment rate while other creditors are relegated to the contract rate, which may be considerably lower. A similar situation would be presented had the instant petition been filed after the maturity date of the bonds (instead of before) and had some of the bondholders succeeded in obtaining judgments on their claims prior to the petition. The inequality which would result were the "moratorium" concept of the court below applied in these situations obviously conflicts with the underlying statutory policy of equality of distribution.[13]

3. In developing its concept of a "moratorium" purpose of Chapter X the court below misconceived the purpose of the restraints which Chapter X imposes upon the entry of judgments and introduced an arbitrary rule in conflict with the flexible equitable considerations governing the allowance of interest claims which this Court so clearly enun-

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[12] The fact that a stay of lawsuits against the debtor rests in the discretion of the reorganization court and is not mandatory under the statute [see Sections 57d, 113, 116(4), 11 U.S.C. §§ 93a, 513, 516(4)] negates the "moratorium" concept of the court below as a statutory prohibition against judgments and their incidents after institution of reorganization proceedings, including the accrual of interest on claims as if they had been reduced to judgment.

[13] Section 63(a)(5) of the Act, 11 U.S.C. § 103(a)(5), for example, endeavors to preserve the statutory policy of equality of distribution among creditors by providing that where claims are permitted to be reduced to judgment after the filing of a petition, costs and interest accrued between the date of the petition and the entry of judgment shall not be allowed as part of the creditor's allowable claim; but this does not destroy its status as a judgment.

ciated in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946).

The purpose of the customary stay of action which the reorganization court has discretion to grant is to avoid a race of the diligent to obtain preferential access to the assets, to insure equality of treatment among creditors, to prevent piecemeal executions, and to provide an orderly and equitable liquidation or reorganization. The normal procedural remedies are thus rendered unavailable, but the purpose of this restraint does not include denial of the substantive rights to which creditors would have been entitled absent the statutory proceedings. As the court below recognizes, at least as regards a straight bankruptcy proceeding, those substantive rights include judgment rights to interest where the entry of judgment has been precluded by the institution of proceedings under the Bankruptcy Act. The greater restrictions imposed by Chapter X upon the exercise of normal creditor remedies, we believe, do not warrant diminution of the allowable claims of creditors in a reorganization under that Chapter. On the contrary, those added restrictions and the slower process of realizing upon a claim in Chapter X make it all the more imperative that the substantive rights of creditors be fully protected in the reorganization process.

The reasoning of the majority below that Chapter X contemplates a "moratorium" which precludes alteration of the contractual relationship between the debtor and its creditors prior to the effective date of a plan overlooks the fact that the contract dealt with would be incomprehensible unless negotiated with reference to the creditor's expectations of obtaining judgment rights. The contract itself provided for a 10-year moratorium of limited scope, including a reduction in the contract rate of interest from 6% to 5% together with contingent provisions for deferring the interest claim to maturity. Regardless of the dispute as to whether the modified contract should be construed as continuing interest at 5% after maturity in the absence of

action by bondholders to enforce their claims, it is inconceivable that bondholders would have consented to the composition had they understood that the debtor could by institution of reorganization proceedings obtain a further moratorium in which the accumulated arrears of interest would be treated as a non-interest bearing claim and the return on principal would continue reduced below the judgment rate.

In denying interest on that part of the bondholders' claim which represented prior unpaid interest, the majority below relied largely upon a local New York policy against the compounding of interest, a policy which it conceded would be inapplicable if the claims were treated as if merged into judgment (R. 217).[14] The court below, however, refused to treat the indebtedness at the date of the petition as a single interest bearing claim. In our view, the holding below is contrary to the provisions of Section 63(a)(1) of the Bankruptcy Act, discussed *supra*, pp. 8-9, and, in addition, contravenes the equitable considerations which this Court, in the *Vanston* case, *supra*, held applicable as respects the allowance of interest in a Chapter X reorganization to the exclusion of any rules under state law.

In the *Vanston* case, which involved a Chapter X reorganization, this Court pointed out that "the touchstone of each decision on an allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor, or between the creditors and the debtor" (329 U.S., at 165). "Where an estate (is) ample to pay all creditors and pay interest even after the petition was filed," this Court observed, "equitable considerations (are) invoked to permit payment of this interest to * * * creditor(s) rather than to the debtor" (329 U.S., at 164). While the actual holding in the *Vanston* case was to deny interest on interest coupons which had matured after the institution of reorganization proceedings, and which were

[14] See also the New York cases cited *infra* n. 16, which treat allowed claims in local insolvency proceedings as if merged into judgments.

left unpaid in consequence of restraints imposed in the course of judicial administration, this interest denial was based solely upon a merging of the equities as between the classes of security holders affected. The estate was insolvent and the proceedings had extended over a period of sixteen years—from equity receivership, to Section 77B, and eventually into Chapter X. The accruals of interest on the overdue coupons were so large that they ate deeply into assets which otherwise would have been available to the junior creditors. To have allowed this additional interest on interest would have enriched the first mortgage bondholders at the expense of the junior creditors whose equity in the estate would have been seriously diminished by the protraction of the proceedings. In effect, allowance of the interest sought by the first mortgage bondholders would have placed upon the junior creditors the expense of a reorganization instituted for the benefit of all creditors.

A similar equitable approach was taken by the court below in the railroad reorganization case of *In re New York, New Haven & Hartford R.R.*, 147 F. 2d 40 (1945), *cert. denied*, 325 U.S. 884 (1945), in which a secured creditor had been enjoined from realizing on pledged collateral at a time when it had substantial market value. By the time the reorganization plan was approved the collateral had become worthless. Under these circumstances the court below held (147 F. 2d, at 48):

> "*The damage to the banks resulting from it (the injunction) ought not equitably to be saddled on them but on the parties for whose supposed benefit the restraint was imposed, and particularly is this true where the decline in the value of the collateral resulted from an act of the debtor itself.* In our opinion fair and equitable treatment requires that the damage caused the banks should be made good to them and that they should be classified as secured creditors to the extent to which they could have realized on their collateral had they not been restrained from selling . . ." (Italics supplied.)

Analogous principles have been applied in other federal liquidations and reorganizations,[15] and, although not controlling in these proceedings, the New York courts give effect to the same equitable considerations in insolvency proceedings.[16]

The instant controversy presents the converse of the *Vanston* case and involves considerations resembling those present in the *New York, New Haven & Hartford R.R.* case. We believe that the equitable doctrines there enunciated require denial of the windfall which the debtor's sole stockholder would reap if the bondholders' matured and undisputed claims were not treated as if merged into judgment. As the reorganization petition substantially admits, the proceedings were instituted for the purpose of safeguarding the stockholder's equity in the debtor's assets, and were dismissed only after the debtor's financial condition had improved sufficiently to warrant that stockholder in advancing funds to discharge the debt. In depriving the bondholders of all rights to interest on a substantial part of their claim which was reducible to judgment at the date of the petition, and in denying them the judgment rate of interest on the balance, a rate to which they would have

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[15] Thus, in *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) in holding that rents and profits belonged ultimately to a mortgagee who was restrained by the bankruptcy court from collecting them pending bankruptcy, the Third Circuit Court of Appeals observed (248 Fed., at 115): "As we are dealing in this case with the equitable administration of bankrupt assets, where creditors' *legal rights are preserved but where their legal remedies are lost and equitable remedies are substituted, equity requires the new remedies to be as effective as the old in protecting and enforcing such rights.*" (Italics supplied.)

See also, *Associated Co.* v. *Greenhut*, 66 F. 2d 428 (C.C.A. 3, 1933), *cert. denied*, 290 U.S. 696 (1933); *In re Wakey*, 50 F. 2d 869 (C.C.A. 7, 1931); *Mortgage Loan Co.* v. *Livingston*, 45 F. 2d 28 (C.C.A. 8, 1930); *In re Torchia*, 188 Fed. 207, 208-209 (C.C.A. 3, 1911).

[16] See *e.g.*, *Dorland* v. *Fidelity Development Co.*, 104 Misc. 97, 99, 171 N.Y. Supp. 1000, 1001 (N.Y. Sup. Ct. 1918); *Skilton* v. *Cordington*, 185 N.Y. 80, 87, 77 N.E. 790, 792 (1906); *Hunting v. Blun*, 143 N.Y. 511, 38 N.E. 716 (1894); *Lang v. Lutz*, 180 N.Y. 254, 260, 73 N.E. 24, 26 (1905).

been entitled absent the abortive Chapter X proceeding, the holding below saddles the creditors with the burden of a reorganization instituted for the benefit of the debtor and its sole stockholder.

We note, in passing, the reliance placed by the majority below upon a number of cases in which the Interstate Commerce Commission and federal courts have approved plans of reorganization which contained provisions for the accrual of interest at the contract rate subsequent to the date of the reorganization petition. As the majority below concedes (R. 214-5), it does not appear that the question as to the proper rate of interest was ever raised or considered in those cases. The opinions and available financial manuals indicate that with one exception [17] those cases all involved claims whose normal maturity dates did not arrive until well after the petition for reorganization,[18] so that the equitable considerations for treating them as if reduced to judgment would appear to be lacking.[19] These cases, moreover, did not deny creditors the right to interest on a claim which was reducible to judgment at the date of the institution of Chapter X proceedings. In view of these circumstances, we do not believe that they are of any value as precedents in the instant controversy.

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[17] *In re Adolf Gobel, Inc.*, Bankruptcy No. 79,526, S.D. N.Y., plan approved June 1, 1944.

[18] Such were the facts in *Ecker* v. *Western Pacific R.R. Corp.*, 318 U.S. 448 (1943); *Brooks* v. *St. Louis-San Francisco Ry.*, 153 F. 2d 312 (C.C.A. 8, 1946), *cert. denied*, 328 U.S. 868 (1946); *Chicago, Rock Island & Pacific Railway Reorganization*, 254 I.C.C. 707 (1943); *In re McKesson & Robbins, Inc.*, 8 S.E.C. 853 (1941), cited by the court below.

[19] We do not urge that a claim which would normally mature after the Chapter X petition is entitled to judgment interest from the date of the petition. In our view, the contract interest governs to the date of normal maturity and, in the case of an undisputed claim, judgment interest thereafter. We do not argue for the allowance of judgment interest as of the date of an accelerated maturity caused by the institution of receivership or reorganization proceedings, since this acceleration may be regarded as a penalty which, under the *Vanston* case, should not be permitted to flow from the institution of such proceedings.

CONCLUSION

The petitions for certiorari should be granted.

Respectfully submitted,

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